PROJECT COOPERATION AGREEMENT & FINANCING PLAN DEVELOPMENT

FINANCIAL ANALYSIS CONCEPTS

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Focus of Remarks:

- Provide an overview of the financial analysis requirements used in support of PCAs;
- Present "Lessons Learned" from several years of working with Sponsor's submissions--

  Things to ask for -- Things to avoid; and
- Discuss real life examples to demonstrate how PCA Financing Plans are unique for each submission.

Overview of PCA Financial Analysis Requirements

FINANCIAL ANALYSIS

COMPONENTS

- Financing Plan -- Sponsor
- Statement of Financial Capability-- Sponsor
- Financial Assessment -- District

Steps in Reviewing the Sponsor's Statement & Plan

- Gather available data sources
- Review Sponsor's submission
- Analyze statement, plan of finance, and construction schedule
- Prepare District report

Overview of PCA Financial Analysis Requirements

FINANCING PLAN -- SPONSOR

- Schedule of estimated expenditures.
- Schedule of sources and uses of funds.
- Explanation of financing for all outlays.

Overview of PCA Financial Analysis Requirements

STATEMENT OF FINANCIAL CAPABILITY -- SPONSOR

- Sponsor’s authority to obtain and utilize source(s) of funds.
- Creditworthiness of Sponsor.
- Relationship and commitment from third parties involved in Project financing.

Overview of PCA Financial Analysis Requirements

FINANCIAL ASSESSMENT --

DISTRICT

- Summarize Sponsor's Plan & Capability.
- Ascertain the reasonableness of Sponsor's financial commitment.
- Assess the risk of non-performance.
- Level of detail dependent on complexity.

Reasonableness of Sponsor's Financial Commitment

- Prior performance of Sponsor.
- Overall financial position of Sponsor.
- Certainty of revenue sources and method of payment (sufficient, reliable & timely).

Analyze Sponsor's Proposed Mix of Funding Sources

- Current available revenues.
- Proposed sale of public assets -- raise cash.
- State grants and/or loans.
- Contributions from other communities and private sources.
- Bond financing- two general types:
  - General Obligations -- full taxing power
  - Revenue Bonds -- backed by fees/charges.

General Obligation Bond Credit Analysis

- ECONOMIC: Demographic trends, income levels, economic diversity, market values of real property
- FINANCIAL: Size of current budget, trends in budget growth and revenue mix, size of cash balances or deficits

General Obligation Bond Credit Analysis

- DEBT: Historic/projected debt burdens, legal capacity/limits, debt service schedule, impact of debt service costs on budget, mix of short-term and long-term bonds
- ADMINISTRATIVE: Professional mgt., tax collection rates, budgetary controls, debt and fiscal policies, lawsuit exposure

Revenue Bond Credit Analysis

- LEGAL: Key legal document is the Bond Resolution or the Trust Indenture; main provisions are the rate covenant, flow of funds structure and reserve funds
- ECONOMIC: Evaluation of the demand for the service and analysis of pledged revenue streams to support operations and debt service

Revenue Bond Credit Analysis

- FINANCIAL: Key factor is debt service coverage (gross revenues minus operating expenses/annual debt service); preferred coverage of at least 1.2X
- ADMINISTRATIVE: Strong management structure is important; ability to justify rates and maintain independence from political pressures

Evidence of Sponsor's Capability

- Administrative support of Project.
- Financial data and final documentation.
- Authorization and legal debt limits.
- *Base of political support of local citizens.*

Summary of District's Assessment

- Review of Financing Plan-is it Reasonable?
- Additional Undue Burden Determination.
- Are the Sponsor's Cost Burdens Understood and are They Affordable?
- Can the Sponsor Operate the Project under Different Cost Scenarios for O&M?
- Minimize Risks to Corps as Signatory.

Municipal Bond Ratings

- Definition: A current assessment of the creditworthiness of an issuer with respect to a specific debt obligation.

AAA AA A BBB = Investment Grade

BB B CCC = Below Investment Grade (Junk)

C = No interest is being paid

D = Bond is in default; No payment of interest and/or repayment of principal.

Lessons Learned from the PCA Process

- Both the sponsor & the Corps often view the Financial Analysis process as a bureaucratic exercise.
- Overcome the urge to make the PCA be a “fill in the blank” process for Corps and Sponsor.
- Third party commitments -- Signatory to the PCA is often not the actual financial contributor.
- Often the State or other party is involved as co-financial sponsor even though not a PCA signatory.

Lessons Learned from the PCA Process

- Sources & Uses of funds must all add up & be on same time frame according to the Federal / Non- Federal Cost Allocation Table.
- O & M costs are very important and need to be included in Financing Plan.
- NO two PCA's /Financing Plan's are the same.
- TIMING equal in importance to Capability/Affordability regarding Finance Plans.

Looking Beyond Bond Insurance

- The role of the Corps in the review of the PCA Plan is akin to that of a credit rating service, except this is a one time evaluation.
- The fact that the local sponsor’s bonds are insured does not guarantee the success of the project.
- Sponsors obtain bond insurance for different reasons -- one may need the policy to ensure market access -- another buys insurance to lower its borrowing costs.

PCA and Competing Capital Projects

- Be aware of competition for sponsor's scarce resources – Economists call it opportunity cost (what you give up to get something)
  – Corps' project is not the only show in town
  – General Obligation bonds might be lowest cost, easiest route to finance project, but other local capital projects might have a claim on lowest cost means of financing.
- Will the PCA project deprive the community of other needed capital improvements?

PCAs and the Political Quotient

- Sponsor needs to be informed and plan EARLY in the PCA process to encourage a base of political acceptance and to be built into sponsor's normal budgeting process.
- Need to be aware of whether funding the costs of the PCA will result in taxpayer backlash.
- Corps should not directly advocate a financing option – but assist in discussing options with the sponsor – avoid steering a particular financing solution since political fallout may result.

The PCA Financing Plan Things to Ask for

- Corps should request data on cost-per-customer --- who pays, how is it paid & how burdensome/ affordable is it?
- Sponsor needs to show source of payment (wage or income tax, sales tax, property tax, water & sewer charge, excess revenues, etc…) and the source of repayment of debt service.
- Who is the ultimate obligor of the local financing? Is it the beneficiaries of the project, all local taxpayers, or third parties?

The PCA Financing Plan Things to Avoid

- Corps role in financial analysis process is unique – does not act as financial advisor.
- Avoid the urge to send sponsors copies of other PCA financing plans -- it often confuses and misleads the sponsor to not think about their unique project requirements and funding.
- Corps should not specifically recommend a particular financing/funding option – Corps can assist in reviewing pros and cons of funding alternatives but final choice is up to sponsors and their financial and legal advisors.

BOND RATINGS OF CITIES WITH CORPS DISTRICTS

- Boston A+
- Chicago A
- Galveston A-
- Louisville AA-
- Memphis AA
- Cincinnati AA
- Detroit BBB
- Huntington A+
- Kansas City AA
- New Orleans BBB

BOND RATINGS OF CITIES WITH CORPS DISTRICTS

- New York A-
- Omaha AAA
- Pittsburgh BBB+
- San Francisco AA-
- Savannah AA
- Seattle AAA
- St. Paul AA
- Walla Walla A
- Washington, DC BB